SMS Capital Management, Inc.

CASE STUDY

High Income Planning (HIP): Portfolio Management

Situation

Joe and Rachel Russell are a married couple living in Dallas, Texas. Joe is an executive at an oil company and Rachel works as an HR manager with an insurance company. Their combined household income puts them in a high marginal tax bracket. They currently have multiple tax advantaged retirement accounts as well as taxable brokerage accounts held with various custodians. They periodically review their accounts, but they do not have an overall investment strategy. The Russells are concerned their investment portfolio is not currently being optimized to achieve their financial goals.

RUSSELL FAMILY SNAPSHOT	
Joe / Rachel's Ages	47 / 45
Annual Household Income	$350,000
Investment Assets	$1,600,000
Net Worth	$2,100,000

Joe and Rachel's objectives include:

- Manage their accounts in a cohesive, holistic fashion that achieves their long-term retirement goals.
- Maximize the after-tax growth of their funds given their desired level of risk.
- Streamline their accounts and tax paperwork where possible.

SMS Portfolio Management Process

Understand the Client's Goals, Objectives, and Risk Tolerance

SMS' approach to portfolio management begins with gaining an understanding of the Russell's particular situation, including goals, needs, constraints, and objectives. As part of the information gathering process, SMS will inquire about the Russell's prior investment experience and ask for copies of existing investment account statements and related documents (i.e. 401ks, pension plans, etc.). The Russells will complete SMS' client profile and risk assessment questionnaire as well as discuss their tolerance for taking risk. SMS will also work with the Russells to ascertain if they are maintaining adequate emergency funds and liquid cash reserves to meet their potential liquidity needs.

SMS will explain its investment philosophy which emphasizes portfolio diversification, elements of both active and passive management, tax minimization, low costs, as well as dynamic and tactical asset allocation strategies aimed at achieving favorable risk-adjusted returns over time.

Develop a Personalized Investment Policy Statement (IPS)

After SMS has gained an understanding of the Russell's risk tolerance, financial goals, and timeframe for achieving all goals, SMS drafts a personalized Investment Policy Statement (IPS). The IPS outlines the governing parameters as to how the Russell's aggregate portfolio will be managed going forward. A cornerstone of the IPS is a recommendation for the appropriate asset allocation that will achieve their goals.

SMS determines that the Russell's main objective is to save for their retirement and that they are moderate risk takers. However, SMS discovers their current account holdings are not consistent with this goal given the large cash balances that have accumulated in their retirement accounts as well as the large concentration to both their employers' stocks. Given the Russell's dual-income household, SMS recommends holding only three months of living expenses in an after-tax money market account.

The Russells review and sign the IPS which will be revisited periodically.

Account Consolidation

After reviewing the Russell's web of twelve investment accounts, SMS sees opportunities to consolidate and streamline the number of accounts down to six. For example, Joe has a 401k from an old employer and two pre-tax IRA accounts held at different custodians that can be consolidated into one IRA account. Rachel also has several IRA accounts including a SEP-IRA from when she was an independent contractor that can be combined.

Having fewer accounts in the portfolio makes it more efficient to manage the funds as a portfolio with a common goal. In addition, they will only have to obtain one 1099 for tax reporting purposes.

Account Consolidation Strategy

Account Owner	No. of Accounts	Account Description	Consolidated Account Type	Consolidated Accounts
Joe	1	401k current employer	401k	1
	2	401k former employer	IRA	2
	3	IRA custodian A		
	4	IRA custodian B		
	5	Roth IRA custodian A	Roth IRA	3
Rachel	6	401k current employer	401k	4
	7	401k former employer	IRA	5
	8	401k former employer		
	9	SEP-IRA		
Joe and Rachel Joint	10	Custodian A	Brokerage (Joint)	6
	11	Custodian B		
	12	Custodian C		

Asset Allocation and Strategic Location

Given the Russell's moderate growth risk profile, the Russell's portfolio will contain stocks for long term growth potential as well as bonds and fixed income vehicles to generate income and manage risk. The concentrated employer stock positions will be reduced and diversified into a broader mix of stock holdings through both passive and active fund vehicles.

SMS strategically places investments in the most tax-efficient accounts. For example, placing a heavier emphasis on holding investments generating ordinary income (i.e. taxable bonds) in the tax-advantaged retirement and IRA accounts will allow for tax deferred compounding. In addition, stock holdings that produce qualified dividend income and long term capital appreciation are placed in the taxable accounts. Using this strategy, the Russells will minimize the drag of taxes over time allowing for greater compounding of returns over the long run.

Repositioning of Portfolio

Investment Assets	Current Asset Allocation		SMS Asset Allocation	
	Value	%	Value	%
Employer Stock	$400,000	25%	$80,000	5%
US Equities	$700,000	44%	$528,000	38%
Int'l Equities	$50,000	3%	$256,000	16%
Balanced Funds	$100,000	6%	$160,000	10%
Fixed Income	$100,000	6%	$528,000	33%
Cash	$250,000	16%	$48,000	3%
TOTAL	$1,600,000	100%	$1,600,000	100%

Planning Impact Summary

- The Russells will consolidate twelve accounts down to six.
- The Russells will receive only one 1099 for the sole brokerage account; thereby streamlining their tax reporting.
- The Russell's assets are being managed to both optimize tax-efficiency and achieve their long term financial objectives.